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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

SHIRLEY P. AUSTIN

Petitioner

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY

Respondents

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit and Brief in Support Thereof

√CHARLES E. HUGHES
Counsel for Petitioner
Shirley P. Austin

APPEAL PRINTING CO., 80 THAMES ST., NEW YORK CITY

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Shirley P. Austin, respectfully shows:

This is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit to review a decision made and entered in said Circuit Court of Appeals on January 7, 1929, reversing a decree of the District Court for the Southern District of New York in a cause in which John C. Barclay and the Willoughby Company are plaintiffs, and Wabash Railway Company and certain individuals, including your petitioner, are defendants (Tr. fols. 8-12).

The purpose of the suit is to assert an equitable credit or lien in favor of holders of Preferred Stock A of Wabash Railway Company in respect of past earnings of said Railway Company and to enjoin payment of dividends upon the Preferred Stock B and Common Stock of the Company until such credit or lien is discharged (Tr. fols. 27-32).

Your petitioner, a general partner in the firm of C. D. Halsey & Company, members of the New York Stock Exchange and registered owners of 15,505 shares of the Common Stock of said Railway Company has been joined as a party to the suit to represent the holders of Common Stock which, as alleged in the Bill of Complaint, are numerous and widely scattered (Tr. fols. 5, 11, 12). As of the latest date shown by the record, the outstanding Common Stock amounts to $66,697,700, consisting of 666,977 shares of the par value of $100 each. Your petitioner is advised that said shares of Common Stock are held by more than 1,000 individuals, firms and corporations (Tr. fols. 9-11).

By the decision of the Circuit Court of Appeals earnings of the Railway Company accumulated during the period from 1916 to 1926 inclusive and amounting to $16,127,250 now invested in road and equipment and held for working capital, are "marked, in a sense, in favor of such (Preferred A) stockholders" and "cannot be used for the payment of dividends on any stock junior to Preferred A until that credit has been satisfied" and in the meantime dividends upon the junior stocks, including the $66,697,700 par value of Common Stock represented by the petitioner, are to be enjoined (Opinion of Circuit Judge MANTON, pp. 6 and 19; Tr. fols. 18, 198, 205).

Reasons for Review.

Wabash Railway Company and certain individuals are submitting to this Court a petition for a writ of certiorari to review said decision and your petitioner respectfully asks leave to unite in said petition and to urge that the writ be granted for the reasons and upon the authorities therein set forth and for the further reason that said decision is in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the case of *Missouri Pacific Railroad Company* v. *Texas and Pacific Railway Company and others,* 282 Fed. Rep. 61.

In addition, your petitioner respectfully asks that this Court consider the following facts which your petitioner submits show the great importance of this cause as affecting alike the interest of the public and the property rights of the common stockholders of Wabash Railway Company and also as affecting the stockholders of many other incorporated companies, both railroad and industrial, having issues of non-cumulative preferred stock outstanding.

(a) **The Public Interest:** An examination of Poor's Manual of Railroads, which contains historical information and detailed data respecting Railway Companies, will disclose that most of the great rail transportation systems of the Country, particularly those which have passed through receivership and reorganization, have financial structures based upon one or more issues of preferred stock which are either wholly non-cumulative or non-cumulative for a stated period of years after organization or reorganization. The underlying purpose of such a financial structure was to give to the Boards of Directors of the companies discretionary power and authority freely to use the corporate earnings in building up these

properties to the standards necessary to enable them to discharge their public obligations—and it was a necessary and vital feature of a financial structure thus conceived that if in any year the Board of Directors found it necessary to apply to capital purposes income which otherwise might have been used for dividends, the non-cumulative preferred stockholder was not entitled to any dividend distribution for that year but was to be compensated for his loss of income by the increased earning power of the corporation and permanency of income in future years. That such was the nature of the non-cumulative Preferred Stock contract is, your petitioner submits, clearly shown by the opinion of Mr. Justice HARLAN in the *Nickals* case, decided at a time when many railroad companies, which are today strong and prosperous, were in process of reorganization. Thus the non-cumulative Preferred Stock certificate of St. Louis Southwestern Railway Company, a reorganized Company created five years after the decision of this Court in the *Nickals* case, provides:

> "The holders of the Preferred Stock are entitled in each year to receive dividends at the rate of five per cent. per annum payable out of the net profits of the Company before any dividends shall be declared or paid on the Common Stock for such year but if in any year dividends amounting to five per cent. shall not be declared payable on the Preferred Stock the holders shall not thereafter receive any further dividends for said year the dividends on the Preferred Stock not being cumulative."

Your petitioner respectfully submits that the decision of the Circuit Court of Appeals, if allowed to stand unreversed, will for reasons hereinafter developed make it necessary for many transportation Companies of the

Country to abandon or restrict the conservative policy of capitalizing earnings when necessary for betterments or improvements and will tend to restrict future financing to income bonds and cumulative Preferred Stock to the great detriment of the public which is vitally interested in sound and conservative financing and efficient transportation service.

(b) **The Disturbance of Vested Property Rights:** Wabash Railway Company was reorganized during the European War with no open mortgage and no currency available for betterments and improvements other than its earnings. For this reason, both of its two issues of Preferred Stock, the Preferred Stock A and the Preferred Stock B, were made non-cumulative. During the period between 1915 and 1926, there were earnings aggregating $37,346,569, all of which, excepting $4,895,361 distributed as dividends upon the Preferred Stock A, was utilized in building up the property to its present standard of efficiency and earning power (Tr. fols. 39-48; 93-95; 198). This policy was pursued while the voting control of the Company rested in the holders of its two issues of non-cumulative Preferred Stock and was not pursued at the expense of the Preferred Stock A for the reason that the larger part of the invested surplus at the end of the year 1926 represented earnings, which, if distributed, would have been distributed to the holders of the Preferred Stock B and Common Stock (Tr. fol. 198).

Your petitioner is informed that at no time prior to the institution of this litigation, was there any claim or suggestion that the Board of Directors of the Railway Company, instead of building up its property for the benefit of all of the stockholders of the Company, were in fact building up a huge dividend credit for the benefit of the

Preferred Stock A. Your petitioner respectfully submits that the creation of such a dividend credit by judicial decree and the "marking" of invested surplus to satisfy such a credit will emasculate the financial structure of the Railway Company, impair the investment of the Common stockholders which your petitioner represents, and cause a widespread disturbance of property rights which have long vested upon the faith of this Court's decision in the *Nickals* case. The far-reaching character of the decision of the Circuit Court of Appeals in its relation to innumerable railroad companies and industrial companies throughout the United States is obvious, but putting aside the effect of the decision upon other companies and the stockholders of other companies and considering only the situation of Wabash Railway Company and the property rights of the holders of the $66,697,700 of its common stock represented by the petitioner, it is submitted that the questions presented are of sufficient importance to justify a review by this Court, particularly in view of the even division of opinion among the Judges of the Circuit Court of Appeals and the District Court and the certainty that the decision of the Circuit Court of Appeals cannot be carried into effect without difficult and disastrous litigation to determine the extent of the dividend credit allowed to the Preferred A stockholders and to determine the extent which particular Preferred A stockholders are entitled to participate in it.

To illustrate:

(1) During the years 1916, 1917 and 1918, there were earnings aggregating $15,486,352 out of which Preferred A dividends were declared and paid in the amount of $2,310,000, leaving a balance of $13,176,352. Against this balance, dividend credits are claimed in the amount of

$5,283,225, so that if the accounts of the Railway Company were recast to mark a part of this surplus to the credit of Preferred Stock A, $5,283,225 thereof would be so marked, leaving a balance of $7,893,127 of surplus either free or marked for the junior issue. But in the years 1919 and 1920, there were operating deficits aggregating $9,918,778 —an amount sufficient entirely to wipe out either the marked surplus or the free surplus and impinge upon the other, and the question at once arises whether such deficits are chargeable wholly against the marked surplus or wholly against the free surplus or chargeable pro rata against the marked surplus and the free surplus, or whether, once a dividend credit has accrued, it survives all future deficits as a continuing charge against the future prosperity of the Company. The petitioner respectfully submits that these questions which arise upon the face of the record are questions which a Board of Directors could not be asked to determine without the protection of a decree of Court.*

(2) It appears from the record that in each of the years 1916 to 1925, inclusive, substantial amounts of Preferred Stock A were issued in conversion of Preferred Stock B, the total outstanding shares of Preferred Stock A increasing from 462,000 in 1917 to 693,058½ in 1925 (Tr. fol. 198). Assuming that the issue of these new Preferred A shares was distributed over a twelve months period in each year in which a dividend credit accrued, there are a minimum of 84 dividend credits, each differing in amount, applicable to the stock outstanding in 1925 which would give 84 different values to an issue of stock, the shares of which are listed on the New York Stock Exchange and have always been bought and sold upon the assumption that all

* See statistical data, Tr. fols. 191-192; 198.

shares had the same value and this situation will be further complicated by the new Preferred Stock issued in conversion subsequent to 1925. Your petitioner earnestly submits that even if it were possible to identify the present outstanding shares with stock issued at a particular date, which in many cases it will be impossible to do, a situation is created which, if the decision of the Circuit Court of Appeals is permitted to stand, is certain to result in long, costly and disastrous litigation to determine the interest of particular Preferred A Stock certificates in the marked surplus.

When these inherent difficulties are considered it is apparent that if the decision of the Circuit Court of Appeals is permitted to stand, companies having non-cumulative preferred stocks outstanding will be obliged in practice to treat them as in effect cumulative and pay dividends thereon when sound judgment and discretion forbids the payment of dividends and will also prevent the use for future capital purpose of unissued amounts of non-cumulative preferred stock which, if put in circulation, would become commingled with other stock of the same issue having dividend credits, giving it a different value and a different relation to corporate surplus.

(c) **Accounting Problems:** Since July 1, 1914, the rail carriers of the United States have been required to keep their accounts in accordance with the uniform classification prescribed by the Interstate Commerce Commission in pursuance of Section 20 of the Act to Regulate Commerce. No rule has ever been prescribed for "marking" corporate surplus as subject to dividend credits in favor of non-cumulative preferred stock, and an analysis of Section 20 would indicate that a situation requiring such an account was not contemplated by Congress. Your pe-

titioner believes and avers that the difficulties of maintaining such an account with constant fluctuations of surplus and constant changes in the volume of outstanding Preferred shares are insuperable, but if the decision of the Circuit Court of Appeals is permitted to stand, the duty will apparently devolve upon the Interstate Commerce Commission to deal with this problem and prescribe the rules whereby the balance sheets of carriers subject to the Interstate Commerce Act will show the corporate surplus marked for dividend credits and truly reflect the interest of the preferred stockholders therein.

(d) **The Destruction of Stock Exchange Markets for Non-cumulative Preferred Stocks:** Your petitioner's firm is represented upon the New York Stock Exchange and upon the New York Curb Exchange which have listed for trading the non-cumulative preferred stocks of many railroad companies and industrial companies, the amounts of which aggregate many hundreds of millions of dollars. Stockholders of these companies will suffer and the Exchanges will suffer if it becomes necessary to discontinue trading in securities of this class. Unlike mortgage bonds which bear serial numbers and which may be identified as to date of issue or any other individual characteristic, shares of stock are represented by certificates which have no permanent identity and when transferred to new owners are cancelled, and the shares represented thereby are divided and united with other shares and new certificates therefor are issued which cannot be traced to or identified with particular shares surrendered for transfer. By this process, which is a daily process in all active transfer offices, shares of stock lose all identity and for purposes of sale are treated and must continue to be treated as an insoluble mass. If, therefore, the decision of the Circuit

Court of Appeals is permitted to stand, it is difficult to understand how the Exchanges can continue to carry upon their trading lists stocks represented by shares which, while apparently equal in all respects, are affected by latent or concealed equities, the extent of which cannot be determined by an analysis of the company's balance sheet and can only be determined if at all by ascertaining the year and the month of the year in which the particular shares are issued.

Your petitioner respectfully submits that the foregoing clearly shows that underlying the decision of the Circuit Court of Appeals are important and far reaching questions of general law which have been erroneously decided by that Honorable Court and which this Court ought to review by writ of certiorari.

Wherefore your petitioner, referring to the attached brief in support of its reasons for review, respectfully prays that this Court issue a writ of certiorari directed to the United States Circuit Court of Appeals for the Second Circuit to certify and send to this Court a full and complete transcript of the record herein, to the end that the said case may be reviewed and determined by this Court as provided by law, and that the decision of said Circuit Court of Appeals may be reversed, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

And your petitioner will ever pray.

SHIRLEY P. AUSTIN.

UNITED STATES OF AMERICA
STATE OF PENNSYLVANIA
COUNTY OF ALLEGHENY

SHIRLEY P. AUSTIN, being duly sworn, deposes and says that he is the petitioner above named; that he has read the foregoing petition by him subscribed and knows the contents thereof and that the facts therein stated are true to the best of his knowledge, information and belief.

SHIRLEY P. AUSTIN.

Subscribed and sworn to before me this 9 day of February, 1929.

(Signed) L. HERMAN,
Notary Public.
[NOTARIAL SEAL]

My Commission expires March 7, 1931.

Certificate.

I certify that I have examined the foregoing petition and that in my opinion the petition is well founded and that the case is one in which the prayer of the petition should be granted by this Court.

CHARLES E. HUGHES,
Counsel for Petitioner Shirley P. Austin.

Supreme Court of the United States

OCTOBER TERM—1928.

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JOHN C. BARCLAY and WILLOUGHBY COMPANY,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

In support of the foregoing petition for a writ of certiorari, the petitioner asks leave to adopt the brief filed herein on behalf of Wabash Railway Company and other individual defendants.

Attention is, however, directed to the case of *Missouri Pacific Railroad Company and others* v. *Texas and Pacific Railway Company and others*, 282 Fed. Rep. 61.

In this case, the Circuit Court of Appeals for the Fifth Circuit, following the decision of this Court in the *Nickals* case, held that income bondholders were not entitled in later years to recover out of accumulated surplus interest for years in which the Board of Directors determined that the current earnings ought to be invested in road and equipment. If an income bondholder must lose his claim to interest when earnings which might have been applied thereto are invested in road and equipment, it is difficult to reconcile such conclusion with the decision of the Cir-

cuit Court of Appeals for the Second Circuit, which gives a superior position to a non-cumulative Preferred Stock.

It is submitted that the decision of the Circuit Court of Appeals for the Second Circuit in the present case is in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the case above cited and that for this reason, in addition to all of the reasons urged in the annexed petition, the decision of the Circuit Court of Appeals for the Second Circuit should be reviewed by writ of certiorari and reversed.

Respectfully submitted,

CHARLES E. HUGHES,
Counsel for Petitioner Shirley P. Austin.